

Internal Revenue Service
memorandum

CC:TL-N-6876-88
Brl:CEButterfield

date: JUN 21 1988

to: Director, Returns Processing and Accounting Division TR:R

from: Director, Tax Litigation Division CC:TL

subject: Form 8615, Computation of Tax for Children Under Age 14 Who Have More Than \$1,000 of Unearned Income

This responds to your request for legal advice by memorandum dated April 25, 1988.

ISSUE

Whether, when the taxpayer filing a form 8615 ("kiddie tax return") fails to include the information about the parents necessary to determine the applicable tax rate, the Service Center may figure the tax using the highest tax rate (38.5% for the 1987 year). 0001-0500.

CONCLUSION

Where the taxpayer requests that the tax be figured for him by the Service but fails to provide the necessary information to determine the rate, calculation at the top marginal rate raises minimal litigation hazards. We recommend, however, that further consideration be given to accepting the 1987 tax year returns as timely, and handling any further processing without the application of penalties. We have also forwarded your request to the Individual Tax Division for a more complete response to the technical questions raised.

FACTS

The 1986 Tax Reform Act has modified the manner in which children under the age of 14 are taxed, so that unearned income over \$1000 is now taxed to the children at the top marginal rate of the parent (this tax on unearned income is known as, and hereafter referred to, as the kiddie tax). The tax is computed on the Form 8615, which is filed with the child's Form 1040. Some of the kiddie tax forms are being filed with insufficient information to figure the applicable tax rate. Certain of these incomplete kiddie tax forms include a request, albeit at times an unsophisticated one, that the Service compute the tax. Other forms are merely incomplete and do not contain any such request.

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LEGAL ANALYSIS

We understand that the practice in the Service Centers has been to compute the tax where requested to do so at the top marginal rate, and to return incomplete kiddie tax returns to the taxpayers as unprocessable where no request to compute the tax is made. In cases where the tax is computed, the tax found owing is treated as a mathematical error, subject to assessment without intermediate jurisdiction of the Tax Court, so that the notice to the taxpayer that the tax has been computed allows them ten days in which to pay the tax and leaves them with the standard remedies of thereafter filing an amended return, and claiming a refund. We understand further that these practices have been developed to minimize contact with taxpayers under the age of 14, and to render as many of the returns processable as possible.

Temporary regulations have been issued under I.R.C. § 1(i), at Temp. Reg. § 1.1(i)-1T, and more recently the Service has published an announcement to assist taxpayers in preparing their kiddie tax returns. The regulations explain the general mechanism of the provision -- to whom it applies and how the applicable rate is calculated. The announcement provided suggestions as to how a timely return could be filed if the parent's information were not available. Originally the announcement (published at I.R.B. 1988-16, 37 (April 18, 1988)) had contained a suggestion that the taxpayer file at the maximum tax rate if they lacked the information regarding the actual rate, and any means by which they could make a reasonable estimate. As published, however, the announcement only suggested that the taxpayer file either a request for an extension of time to file or an estimated return. No penalties would attach to a good faith estimate, and any overpayment resulting from an estimate would be subject to interest from the date of filing, which would be payable with a refund requested after filing an amended return.

Unfortunately, the announcement was not published until after the filing deadline for 1987 returns. The 1987 year raises the greatest difficulties in processing incomplete returns, because there are more tax brackets in 1987 than will apply to the 1988 year. Therefore taxpayers were not notified that estimated returns would be accepted until after they had filed their incomplete returns. This leaves the question of what to do with the incomplete returns that were filed.

The authorization to figure the tax on an incomplete return is found in section 6014, which only applies when the taxpayer

requests that the tax be figured. Faced with such a request, and no information to determine the rate, the only practical alternative would appear to be to figure the tax at the top marginal rate. Authority to place the taxpayer in refund status would then be found in sections 6201 (general assessment authority) and 6213 which excludes from Tax Court jurisdiction notices of deficiency based on clerical or mathematical error. A clerical error is defined at 6213(g)(2)(D) to include:

an omission of information which is required to be supplied on the return to substantiate an entry on the return...

Faced with defending the application of this section to the omission of the parent's return when the application had already been made, we believe that litigation could be managed in some acceptable way. However our advice is largely speculation, since it is unlikely that the issue will ever rise to the level of refund litigation. (Although collection action might give rise to lawsuits that would be within the jurisdiction of the General Litigation Division.) Moreover, were it to reach that stage, we would still have the option of settling any and all such lawsuits that were to arise, thereby avoiding adverse precedent.

Our consideration is limited to the question of what is defensible. Of more concern to you, however, is the issue of how best to proceed. To some extent that is a matter of policy, and we understand and sympathize with the coincident desires to avoid excessive communication with children, and to process as many of these defective returns as possible. We understand that in the past, where returns were submitted without Forms W-2, or without sufficient substantiation of foreign taxes, a special handling notice was developed so that the return could be sent back to the taxpayer for supplementation but would be counted as timely filed by the Service Center when it was received back there with the special handling notice attached. We would certainly advocate the development of a similar method of handling these returns.

The announcement describing the estimated return procedure stated that no penalties would attach to estimated returns for underpayments. We would recommend that some procedure be developed by which any good faith kiddie tax return filed before April 15, 1988, would be accepted as timely, no matter how defective. This course would be advisable given that the notice was not available to taxpayers until after the filing deadline, and given the novelty of the provision, and the particular disadvantage under which children are placed in attempting to understand their responsibility for the tax and comply with it. If no penalties were to be applied to these

returns, the likelihood of any administrative course of action being challenged in litigation is rendered even more remote.

This is the best advice we can provide to you on the question of litigation hazards raised by the treatment you propose. We believe that general technical advice is called for on the question of whether or not the sections mentioned above authorize us to process incomplete returns at the highest tax rate, and what alternatives may be available short of sending the return back to the taxpayer as unprocessable. Therefore, at the same time as we provide this to you, we are forwarding your memorandum to the Individual Tax Division for their direct response to you on that issue. If you wish to contact someone there, we suggest you call Mr. Alan Peregoy, at 566-3626, with whom we understand you have already been in contact. We believe that the Individual Tax Division can be of more assistance to you in responding to the general questions you raise.

Please do not hesitate to contact Ms. Clare E. Butterfield, at 566-3442, if you have any further questions regarding this memorandum. Moreover, we will attempt to coordinate the efforts of the various Divisions in the Office of Chief Counsel on this subject, as it develops.

MARLENE GROSS

By: Richard L. Carlisle
RICHARD L. CARLISLE
Senior Technician Reviewer
Branch No. 1
Tax Litigation Division